

Office of Chief Counsel
Internal Revenue Service

memorandum

CC:NER:PEN:PHI:TL-N-5440-99
JCFee

date:

to: Chief, Quality Measurement Staff, Pennsylvania District
Attn: Marshall Lyons

from: Assistant District Counsel, Pennsylvania District, Philadelphia

subject:

[REDACTED]
EIN: [REDACTED]; Tax Years: [REDACTED], [REDACTED], and [REDACTED]
Computation Date for Accrual of Deficiency Interest

DISCLOSURE STATEMENT

This advice constitutes return information subject to I.R.C. § 6103. This advice contains confidential information subject to attorney-client and deliberative process privileges and if prepared in contemplation of litigation, subject to the attorney work product privilege. Accordingly, the Examination or Appeals recipient of this document may provide it only to those persons whose official tax administration duties with respect to this case require such disclosure. In no event may this document be provided to Examination, Appeals, or other persons beyond those specifically indicated in this statement. This advice may not be disclosed to taxpayers or their representatives.

This advice is not binding on Examination or Appeals and is not a final case determination. Such advice is advisory and does not resolve Service position on an issue or provide the basis for closing a case. The determination of the Service in the case is to be made through the exercise of the independent judgment of the office with jurisdiction over the case.

You have informally requested our legal advice on the proper date for computing deficiency interest where the taxpayer has elected to apply it overpayments of tax per return to the following year's estimated tax deposits.

ISSUE:

At what date does interest begin to run on a deficiency in tax for a particular year, where the taxpayer had previously reported an overpayment of tax on its return and elected to have the overpayment credited against its estimated tax liability for the succeeding year.

CONCLUSION

To the extent the taxpayer's deficiency results from the use of a credit elect to satisfy estimated tax liabilities, deficiency interest will be assessed as of the dates the excessive credit is applied to the succeeding year's estimated taxes. Interest will be computed as of the original due date of the succeeding year's income tax return, if the excessive credit was not needed to satisfy specific installments of estimated tax.

FACTSTAX YEAR SEPTEMBER 30, [REDACTED]

[REDACTED] timely filed its tax returns for the year ended September 30, [REDACTED] on the extended due date of [REDACTED]. The [REDACTED] return reflected an overpayment of \$ [REDACTED], which [REDACTED] elected to apply to the corresponding subsequent tax year's estimated taxes. [REDACTED] did not designate the quarterly installment to which the overpayment should be applied, the Service applied the reported overpayment to the first quarter of the [REDACTED] tax year, pursuant to Rev. Rul. 84-58, 1984-1 C.B. 254. Accordingly, the Service applied the entire overpayment to the first [REDACTED] estimated payment as of [REDACTED].

On audit, the Service determined a deficiency of \$ [REDACTED] for [REDACTED] (less than the amount of \$ [REDACTED] reported return overpayment). In determining when deficiency interest would begin to run on the \$ [REDACTED] deficiency, the Service concluded that interest should run from [REDACTED], the due date of the first installment of [REDACTED] estimated payments.

TAX YEAR SEPTEMBER 30, [REDACTED]

[REDACTED] timely filed its tax return for the year ended September 30, [REDACTED] on the extended due date of [REDACTED]. The [REDACTED] return reflected an overpayment of \$ [REDACTED], which [REDACTED] elected to apply to the subsequent tax year's ([REDACTED]) estimated tax liability. Since [REDACTED] did not designate the quarterly installment to which the overpayment should be applied, the Service applied the reported overpayments to the first quarter for the

subsequent tax year, pursuant to Rev. Rul. 84-58, 1984-1 C.B. 254.

On audit, the Service determined a net deficiency for [REDACTED] in the amount of \$[REDACTED] (less than the reported return overpayments of \$[REDACTED]). In determining when deficiency interest would begin to run on [REDACTED]'s deficiency, the Service concluded that interest should run from [REDACTED], the due date of the first installment of [REDACTED] estimated payments.

TAX YEAR SEPTEMBER 30, [REDACTED]

[REDACTED] timely filed its tax return for the year ended September 30, [REDACTED], on the extended due date of [REDACTED]. The [REDACTED] return reflected an overpayment of \$[REDACTED], which [REDACTED] elected to apply to the corresponding subsequent tax year's ([REDACTED] estimated taxes. Since [REDACTED] did not designate the quarterly installment to which the overpayment should be applied, the Service applied the reported overpayment to the first quarter for the subsequent tax year, pursuant to Rev. Rul. 84-58, 1984-1 C.B. 254.

On audit, the Service determined a net deficiency for [REDACTED] in the amount \$[REDACTED] (less than the reported return overpayments of \$[REDACTED] for [REDACTED]). In determining when deficiency interest would begin to run on [REDACTED]'s deficiency, the Service concluded that interest should run from [REDACTED], the due date of the first installment of [REDACTED] estimated payments.

Claims For Refund

[REDACTED] has now filed claims for refund for each of the tax years discussed herein, with respect to the deficiency interest assessed and paid based on use of money principles. [REDACTED]'s position is that since it did not need the entire overpayment to avoid the estimated tax penalty, interest should not begin to accrue until the overpayment is needed or used to pay the installment due. Based on the analysis submitted by [REDACTED] with its claim, the overpayment is applied as follows:

[REDACTED] OVERPAYMENT CREDIT APPLIED TO [REDACTED]

<u>Installment Period</u>	<u>Installment Due</u>	<u>E/S Payment</u>	<u>Overpayment Credit Applied</u>
[REDACTED]	\$ [REDACTED]	[REDACTED]	\$ [REDACTED]
[REDACTED]	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]
[REDACTED]	\$ [REDACTED]	[REDACTED]	\$ [REDACTED]
[REDACTED]	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]

[REDACTED] OVERPAYMENT CREDIT APPLIED TO [REDACTED]

<u>Installment Period</u>	<u>Installment Due</u>	<u>E/S Payment</u>	<u>Overpayment Credit Applied</u>
[REDACTED]	\$ [REDACTED]	[REDACTED]	\$ [REDACTED]
[REDACTED]	\$ [REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	\$ [REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	\$ [REDACTED]	[REDACTED]	[REDACTED]

[REDACTED] OVERPAYMENT CREDIT APPLIED TO [REDACTED]

<u>Installment Period</u>	<u>Installment Due¹</u>	<u>E/S Payment</u>	<u>Overpayment Credit Applied</u>
[REDACTED]	\$ [REDACTED]	\$ [REDACTED]	[REDACTED]
[REDACTED]	\$ [REDACTED]	[REDACTED]	\$ [REDACTED]
[REDACTED]	\$ [REDACTED]	[REDACTED]	\$ [REDACTED]
[REDACTED]	\$ [REDACTED]	\$ [REDACTED]	[REDACTED]

¹ We are constrained to note that in performing an analysis of what portion of an overpayment is applied to a quarterly estimated payment to avoid the penalty, there is has been no effort by the Internal Revenue Service to verify the taxpayer's computations of annualized income. In other words, this analysis is based entirely on the Form 2220 as filed by the taxpayer.

LAW AND ANALYSIS

Rev. Rul. 88-98, 1988-2 C.B. 356, holds that when a taxpayer elects to credit an overpayment from a return (i.e. the taxpayer makes a "credit elect") and the credit is applied in full against a particular installment of the succeeding year's estimated tax, interest on a subsequently determined deficiency for the earlier year runs from the due date of that installment on the part of the deficiency equal to or less than the credit elect. Rev. Rul. 88-98 follows Avon Products, Inc. v. United States, 588 F.2d 342 (2d Cir. 1978), in which the court interpreted section 6601(a) to mean that interest on a deficiency can only be charged when the tax is both due and unpaid. The date the overpayment becomes a payment on account of the succeeding year's estimated tax determines when the prior year's tax became unpaid for purposes of section 6601(a), and thus when deficiency interest begins to run. Prior to that date the government has had the use of the funds with respect to the prior year's tax.

In May Department Stores Co. v. United States, 36 Fed. Cl. 680 (1996), acq. AOD CC-1997-008 (Aug. 4, 1997), the taxpayer elected to credit an overpayment shown on its 1983 tax return to the succeeding year's estimated tax liability but did not attach a statement to its return indicating the installment to which the Service should apply the credit. A deficiency was determined for the taxpayer's 1983 tax year, and interest was assessed from the due date of the first installment in accordance with Rev. Rul. 88-98. However, the taxpayer had made estimated tax payments sufficient to avoid the addition to tax imposed by section 6655 for 1984 for the first and second installments. The court concluded the Service's application of taxpayer's 1983 overpayment to the first installment did not change the fact that the government had the use of taxpayer's overpayment from the due date of the first installment (May 15) to the date taxpayer filed its 1983 tax return (October 15), since the overpayment was not needed to satisfy any installment of estimated tax due during that period.

In Rev. Rul. 99-40, 1999-40 IRB 1, the Service reconsidered the manner in which deficiency interest is computed in light of the May Department Stores decision. When a taxpayer makes an election to apply an overpayment to the succeeding year's estimated taxes, the credit is applied to unpaid installments of estimated tax due on or after the date the overpayment arose, in the order in which they are required to be paid to avoid an addition to tax for failure

to pay estimated income tax under sections 6654 and 6655. The Service will assess interest on a subsequently determined deficiency from the date the credit is applied to the succeeding year's estimated taxes. The unused balance of the credit is deemed effective as a payment of the succeeding year's income tax liabilities as of the unextended due date of the return.

For [REDACTED]'s [REDACTED] tax year, the credit elect exceeded the subsequently determined deficiency. To avoid the estimated tax penalty, [REDACTED] needed \$[REDACTED] of the [REDACTED] credit elect in the first quarter of [REDACTED], \$[REDACTED] in the second quarter, \$[REDACTED] in the third quarter, and \$[REDACTED] to avoid the penalty for the fourth quarter. With a reported overpayment of \$[REDACTED] in [REDACTED], which [REDACTED] elected to credit toward its estimated tax liability in [REDACTED], and a subsequently determined deficiency of \$[REDACTED], which was LESS than the reported overpayment, [REDACTED] was ENTITLED to an overpayment of \$[REDACTED] for [REDACTED]. Therefore, [REDACTED] will be treated as using the \$[REDACTED] to which it was ENTITLED² to make its estimated tax payments, before making use of the "excessive" credit elect that created its [REDACTED] deficiency. Thus, only \$[REDACTED] of the excessive credit (\$[REDACTED] less \$[REDACTED]) was used to pay the first quarter estimated tax liability. See, Rev. Rul. 99-40, 1999-40 IRB 1, Situation 2.

For tax years [REDACTED] and [REDACTED], the credit elect amount was well in excess of the subsequently determined deficiencies. [REDACTED] was ENTITLED to an overpayment of \$[REDACTED] in [REDACTED] and \$[REDACTED] as shown below:

	[REDACTED]	[REDACTED]
Credit Elect	\$ [REDACTED]	\$ [REDACTED]
Less: Deficiency	[REDACTED]	[REDACTED]
Credit Elect to which		
[REDACTED] was ENTITLED	\$ [REDACTED]	\$ [REDACTED]

² i.e. the overpayment per return in excess of the subsequently determined deficiency.

The taxpayer also made estimated tax payments of \$ [REDACTED] for [REDACTED] and \$ [REDACTED] for [REDACTED].

Since the [REDACTED] estimated tax liability of \$ [REDACTED] per quarter (\$ [REDACTED] total) was fully satisfied by (1) the [REDACTED] credit elect to which the taxpayer was ENTITLED and (2) the estimated payments actually made, none of the "excessive" credit elect that created its [REDACTED] deficiency was used to satisfy the [REDACTED] estimated tax liability. Accordingly, interest on the [REDACTED] deficiency should begin to run on [REDACTED], the due date of the [REDACTED] return.

The [REDACTED] estimated tax liability was satisfied as follows in accordance with Situation 2 of Rev. Rul. 99-40:

<u>Installment Period</u>	<u>Installment Due</u>	<u>E/S Payment</u>	<u>Application of Credit Elect to which TP is ENTITLED</u>	<u>Application of Excessive Credit Elect</u>
[REDACTED]	\$ [REDACTED]	\$ [REDACTED] (a)	[REDACTED]	[REDACTED]
[REDACTED]	\$ [REDACTED]	\$ [REDACTED] (a)	\$ [REDACTED]	[REDACTED]
[REDACTED]	\$ [REDACTED]	[REDACTED]	\$ [REDACTED] (c)	\$ [REDACTED]
[REDACTED]	\$ [REDACTED]	\$ [REDACTED]	[REDACTED]	[REDACTED]
Totals	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]

(a) The taxpayer paid \$ [REDACTED] for the first quarter, of which only \$ [REDACTED] was required to satisfy the estimated tax liability; the balance of \$ [REDACTED] was carried to the second quarter.

(b) This amount represents the balance of the \$ [REDACTED] credit elect from [REDACTED] to which petitioner was ENTITLED. The \$ [REDACTED] remainder of the second installment was satisfied by the "excessive" credit elect that created its [REDACTED] deficiency.

Except for \$ [REDACTED], the entire [REDACTED] estimated tax liability was satisfied by (1) the [REDACTED] credit elect to which the taxpayer was ENTITLED and (2) the estimated payments actually made. Accordingly, interest on \$ [REDACTED] the [REDACTED] deficiency should begin to run on [REDACTED], the due date

of the third estimated tax installment. Interest on balance of the [REDACTED] deficiency (\$[REDACTED]) should begin to run on [REDACTED], the due date of the [REDACTED] return.

To summarize, deficiency interest shall be computed with reference to the following:

<u>DEFICIENCY INTEREST REBATE - FISCAL</u>	
YEAR [REDACTED]	
[REDACTED] FYE OP Credit Elect to FYE [REDACTED]	
Deficiency Assessed Per Transcript:	
[REDACTED] Assessment	[REDACTED]
[REDACTED] Abatement	[REDACTED]
[REDACTED] Assessment	[REDACTED]
Total Deficiency [REDACTED]	
Interest Start date	On:
[REDACTED] Form 2220	
(\$ [REDACTED] Less \$ [REDACTED])	\$ [REDACTED]
[REDACTED] " "	\$ [REDACTED]
[REDACTED] " "	[REDACTED]
[REDACTED] " "	[REDACTED]
[REDACTED] Due date of [REDACTED] Return	[REDACTED]
Total OP Applied to Deficiency [REDACTED]	

<u>DEFICIENCY INTEREST REBATE - FISCAL</u>	
YEAR [REDACTED]	
[REDACTED] FYE OP Credit Elect to FYE [REDACTED]	
Deficiency Assessed Per Transcript:	
[REDACTED] Assessment	[REDACTED]
[REDACTED] Abatement	[REDACTED]
[REDACTED] Assessment	[REDACTED]
Total Assessment FYE [REDACTED]	
Interest Start Date :	On:
[REDACTED] Due Date [REDACTED] Return	[REDACTED]

[REDACTED]		[REDACTED]
<u>DEFICIENCY INTEREST REBATE - FISCAL</u>		
YEAR	[REDACTED]	
[REDACTED]	FYE OP Credit Elect to FYE	[REDACTED]
Deficiency Assessed Per Transcript:		
[REDACTED]	Assessment	[REDACTED]
[REDACTED]	Abatement	[REDACTED]
[REDACTED]	Assessment	[REDACTED]
Total Assessed Deficiency FYE	[REDACTED]	
Interest Start Date:		
[REDACTED]	" "	\$ [REDACTED]
[REDACTED]	Due date of [REDACTED] Return	\$ [REDACTED]
Total OP Applied to Deficiency		\$ [REDACTED]

This concludes our advice and recommendation. Please feel free to call Attorney James C. Fee, Jr. at 215-597-3442 with any additional questions you may have. We are forwarding a copy of this advice to the Assistant Regional Counsel (Tax Litigation) (CC:NER) and to the Office of Assistant Chief Counsel (Field Service) (CC:DOM:FS) for mandatory 10 day post review. To assure that the National Office has had sufficient time to review our advice, we request that you refrain from taking any action with respect to the taxpayer's claim prior to October 29, 1999.

JOSEPH M. ABELE

Assistant District Counsel

cc: Assistant Regional Counsel (Tax Litigation) (CC:NER)
 Office of Assistant Chief Counsel (Field Service) (CC:DOM:FS)